

DEPARTMENT OF STATE REVENUE**LETTER OF FINDINGS NUMBER: 98-0755****Adjusted Gross Income Tax
For Years 1994, 1995 and 1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES**I. Adjusted Gross Income Tax—Add back of Property Taxes**

Authority: None

Taxpayer protests the add back of property taxes.

II. Adjusted Gross Income Tax--Inventory Adjustment

Authority: 45 IAC 3.1-1-44

Taxpayer believes that the Department made an error in calculating the inventory adjustments.

III. Adjusted Gross Income Tax—Dividend Expense Attribution

Authority: IC § 6-3-2-12; IC § 6-3-1-11(b); IRC §§ 78, 863

Taxpayer believes that the results generated by the auditor are unreasonable.

IV. Adjusted Gross Income Tax—Exclusion of rent from 1996 sales denominator

Authority: 45 IAC 3.1-1-50; 45 IAC 3.1-1-51

Taxpayer believes that rent should be included in 1996 sales denominator.

V. Tax Administration—Waiver of Penalties

Authority: IC §6-8.1-10.2.1; 45 IAC 15-11-1; 45 IAC 15-11-2

Taxpayer believes the assessment of penalties is inappropriate.

STATEMENT OF FACTS

Taxpayer is a manufacturer of protective and decorative coatings, flat glass, fabricated glass products, continuous-strand fiber glass products, and industrial and specialty chemicals. Taxpayer operates manufacturing facilities worldwide. Taxpayer protests several issues regarding Indiana gross income tax adjustments for the years 1994 through 1996. Additional information will be supplied as needed.

I. Adjusted Gross Income Tax—Add back of Property Taxes

DISCUSSION

The taxpayer protests the add back of property tax. The taxpayer was a 99% partner in GP. The taxpayer included 99% of GP's property in their property factor. GP owns the building which is occupied by the taxpayer. Therefore, the Department added back 99% of the property for which GP is liable.

The taxpayer states that the taxes for the building and surrounding land are the responsibility of MV, Inc. In addition, the taxpayer contends that there is no basis for the Department's add back when the property taxes in question were never deducted as an expense by the taxpayer.

The owner of the property in question has the ultimate responsibility to pay the property taxes. The entity that is legally responsible for the payment of the taxes in question is also subject to the add back of those taxes. In this instance, the taxpayer is not legally responsible for the payment of the property taxes. The add back is not proper because the taxpayer never deducted the taxes from its gross income.

FINDING

The taxpayer's protest is sustained.

II. Adjusted Gross Income Tax—Inventory Adjustment

DISCUSSION

Taxpayer claims that the Auditor made an error in calculating the adjustment for the denominator of the Property Factor. Taxpayer claims that it reports the numerator and denominator amounts on a FIFO basis, but that the Auditor shows the numerator on a FIFO basis and the denominator on a LIFO basis.

While both the numerator and denominator are consistent with the figures shown on taxpayer's federal return, the numerator and denominator for the inventory calculations should match. 45 IAC 3.1-1-44 states "Inventory is included in the property factor in accordance with the valuation method used by the taxpayer for Federal income tax

purposes.” Since taxpayer reports the denominator, or “everywhere” portion, on its federal returns on a LIFO basis, the numerator should be adjusted from FIFO to LIFO basis. This way, the numerator and denominator will both have a LIFO basis, and the numbers used for state returns will match the numbers used for federal returns.

FINDING

The taxpayer’s protest is sustained. The figures will be submitted to the Auditor for recalculation.

III. Adjusted Gross Income Tax—Dividend Expense Attribution

DISCUSSION

Taxpayer protests the expense attribution calculation of the dividend adjustment. Taxpayer claims that results generated by the auditor are unreasonably high. The auditor, as set forth in IC § 6-3-1-11(b), relied on the Internal Revenue Code as a method of allocating those expenses, since the Indiana Code and Regulations provide no method for the attribution of expenses associated with foreign source income. IC § 6-3-1-11(b) provides:

Whenever the Internal Revenue Code is mentioned in this article, the particular provisions that are referred to, together with all the other provisions of the Internal Revenue Code in effect on January 1, 1998, that pertain to the provisions specifically mentioned shall be regarded as incorporated in this article by reference and have the same force and effect as though fully set forth in this article. To the extent the provisions apply to this article, regulations adopted under Section 7805(a) of the Internal Revenue Code and in effect on January 1, 1998, shall be regarded as rules adopted by the department under this article, unless the department adopts specific rules that supercede the regulation.

The Auditor therefore referred to Internal Revenue Code §863, which provides:

- (a) Allocation under Regulations. Items of gross income, expenses, losses and deductions other than those specified in sections 861(a) and 862(a), shall be allocated or apportioned to sources within or without the United States, under regulations prescribed by the Secretary. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the taxable income therefrom) the expenses, losses and other deductions properly apportioned or allocated thereto and ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some items or class of gross income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

The auditor used the taxpayer's Federal 1118 to determine the amounts of foreign dividend expenses. Total unallocable foreign expenses were divided by total foreign income (not including gross-up) to yield the percentage of foreign expenses to income. That percentage was then excluded from the foreign dividend exclusion amount to yield net foreign dividend exclusion.

Since there are no provisions in the Indiana Code or Regulations, under IC § 6-3-1-11(b) the auditor was correct in following federal guidelines.

FINDING

The taxpayer's protest is denied.

IV. Adjusted Gross Income Tax—Exclusion of rent from 1996 sales denominator

DISCUSSION

Taxpayer protests exclusion of rent from the sales denominator for the year 1996. The auditor did include rent for the years 1994 and 1995. 45 IAC 3.1-1-50 (4) states, "If the taxpayer is in the business of renting real or tangible property, 'sales' includes the gross receipts from the rental, lease, or licensing the use of the property." 45 IAC 3.1-1-51 states, "The denominator of the sales factor includes all gross receipts from the taxpayer's sales, except as noted in Regulation 6-3-2-2(1)(010)."

Since the taxpayer is in the business of renting real or tangible property, the denominator should include all gross receipts from rents.

FINDING

The taxpayer's protest is sustained. The figures will be submitted to the Auditor for recalculation.

V. Tax Administration—Penalty

DISCUSSION

The taxpayer protests the Department's imposition of the ten percent (10%) penalty assessment. Indiana Code section 6-8.1-10-2.1 requires a ten percent (10%) penalty to be imposed if the tax deficiency is due to the negligence of the taxpayer. Department regulation 45 IAC 15-11-2 provides guidance in determining if the taxpayer was negligent in nature.

Departmental regulation 45 IAC 15-11-1(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable

taxpayer.” Negligence is also to be determined on a case-by-case basis according to the facts and circumstances of each taxpayer.

Subsection (d) of IC 6-8.1-10-2.1 allows the penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish reasonable cause, the taxpayer must show that it “exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . .”

In this instance, the taxpayer has not shown reasonable cause. The taxpayer has not provided to the Department’s satisfaction, sufficient justification for interpreting the code as it did.

FINDING

The Taxpayer’s protest is denied. The taxpayer has not provided to the Department’s satisfaction, sufficient justification for interpreting the code as it did.